UNITED STATES NAVAL POSTGRADUATE SCHOOL

RESEARCH

THE ELEMENTS OF ESTATE PLANNING
FOR MILITARY OFFICERS

L. H. C. Thiel

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FOR MILITARY OFFICERS

by

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Lieutenant Commander, United States Navy

Submitted in partial fulfillment of
the requirements for the degree of

MASTER OF SCIENCE
IN
MANAGEMENT

United States Naval Postgraduate School
Monterey, California

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ABSTRACT

Estate planning for a military officer and his family has the same fundamental objective of financial security as any estate program. The officer's estate has a sizeable foundation varying with pay grade and length of service. Some of this foundation is applicable only as a result of the officer's death on active military duty. Social Security benefits and military retirement pay are also estate considerations.

An estate model can be constructed depicting "estate needs" and "present estate". The present estate normally is much less than that desired for the "peace of mind" so necessary for a dedicated military career. Some types of insurance and investments are more compatable with the officer's career and estate goals than others. A critical analysis of estate needs and a positive action on the selected estate building techniques can insure the officer and his family financial security for the rest of their lives.

PREFACE

"The computer age" has influenced and revised many heretofore routine and laborious tasks. The modern electronic computers have attained a position and reputation for producing problem solutions previously unobtainable by the human mind. Much of this reputation is well deserved. Other portions are greatly exaggerated.

Most insurance companies now offer a "computerized estate planning service". By providing the computer with the appropriate personal data, it will punch out a group of figures purporting to be "estate shortage" and "insurance required". The use of the computer for this purpose is not condemned by this writer, however, the widespread claims have magnified the subject of estate planning. The implication is that estate planning is a complex art, the successful achievement of which is based on complicated predictions and mathematics.

This paper has purposely been written at a level to allow the basic principles of estate planning, insurance, and investment to be easily understood by any officer and his wife. Hopefully, all who read it will obtain some benefit, if nothing more than the ability to converse intelligently with the many agents and brokers contacted for estate building purposes.

The elements of estate planning discussed in this paper are the same as those processed by the computer programs. By understanding the principles, and removing the "shroud of awe" from the subject of estate planning, it is hoped that each officer will have a better understanding of the estate planning procedure, and take positive steps to insure financial security for himself and his family.

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CHAPTER I

THE IMPORTANCE OF ESTATE PLANNING

Financial security is an important element of "peace of mind" for any workman in the successful achievement of a job "well done". The importance of financial security to the executive "decision-maker" has long been recognized in industry to the extent that high industrial executives have delayed salaries, contracts, and stock options associated with their positions. This position of financial security is considered important so that the future livelihood (or financial position) of the executive should never need to be influential in any important decision.[1]

The military organizations of the Defense Department comprise the biggest industries in the world. Competent management and capable personnel are no less important to these organizations as outstanding management talent is to any commercial enterprise. The "peace of mind" of military managers is probably more important as the additional pressure of decisions involving "life and death" can be routine in military management. Distractions, outside worries, or internal insecurity can influence judgement and lead to poor decisions. Financial worries, promotion worries, and family obligations, unfortunately, can all subconsciously influence even the most competent minds and decisions.

The moral and social obligations of responsibility to one's family, if something should happen to the "breadwinner", and the more common goal of a

[1]Harold Koontz and Cyril O'Donnel, _Principles of Management_ (New York: McGraw-Hill Book Company, Inc., 1959), pp. 217-18.

comfortable existence as a retired "senior citizen" are financial considerations that can be demanding both consciously and unconsciously.

The military "Survivor's Benefit Program" and the retirement plan contribute in some way to a sense of well being in the financial security area, but any knowledge of the value and limitations of these benefits would label them as "inadequate" for complete complacency regarding financial security.

The purpose of this paper is to present the "Elements of Estate Planning for Military Officers" in such a manner that the "Military Executive" can analyze his present estate, his needs, and consider alternative methods of equating his estate to meet the needs of his family in the eventuality of the officer's untimely death and the more pleasant eventuality of retirement.

Much literature, many "expert counselors", and as many varied opinions on estate planning, moral and social obligations, and clever economic practices are available to solve any problem in this area. Unfortunately, even the most conscientious individual gets discouraged by the amount of conflicting (and convincing) material and opinions that are intended to ease the "estate planning" problem.

During the course of research for this paper, insurance agents, mutual fund brokers, bankers, economists, and real estate agents were interviewed. A wealth of textbooks, periodicals, pamphlets, and articles were reviewed and analyzed. Convincing arguments with statistical support are available to prove that for any sound financial estate you should: (1) Buy government bonds, keep your money in a savings account, or bury your money in a coffee can,[2] or (2) buy insurance, preferably a "permanent type"[3], or (3) invest in

[2] William J. Baxter, Serious Trouble Ahead! (New York: International Economic Research Bureau, 1964), p. 75.

[3] R. C. Allen, The Truth About Life Insurance (Louisville, Kentucky: Insurance Reporting Service, 1962), p. 31.

mutual funds for sound growth.[4] The only opinion that is universal from interviews and printed matter is that playing the common stock market (other than "blue chip" stocks) may be successful but should only be undertaken by: (1) financial and economic experts, (2) lucky gamblers, or (3) philanthropists who are not too hardshipped by losing.

The material in this paper is not intended to provide the "optimum" answer to estate formulation or to make everyone a retired millionaire. The material presented in this paper will provide the military officer with sufficient information and methods to: (1) determine his financial estate resulting by virtue of his military service, (2) enable him to construct a financial model and analyze his requirements, and (3) provide unbiased information on methods available to provide an estate that equals predetermined requirements.

The material in this paper is not intended to ignore minority classifications of officers such as bachelors, dependent parents, or childless households, but space limitations prevent a complete analyses of all categories.

The presentation of the material in this paper will be directed toward planning a family estate. An estate planning example will be developed for a fictional Lieutenant (pay grade 0-3) I. M. Clever, USN, a 28 year old officer; his wife, Wilma, age 26; a son, Mike, age four; and a daughter, Susie, age two.

Sufficient information is provided for each officer to conduct a similar analysis of his own estate and provisions. Military pay scales are not provided as they are easily obtained and under current revision hearings.

[4] Arthur Wiesenberger, "The Modern Way To Invest" ([n.p.]: Arthur Wiesenberger & Company, 1961), p. 12. (Pamphlet)

CHAPTER II

DETERMINING ESTATE REQUIREMENTS

How much money would be required to provide a lifetime independent livelihood for the family if the "breadwinner" were to die? How much money will be needed to provide a comfortable retirement? How much will a gallon of milk and a dozen eggs cost next year?..Ten years from now?..Twenty years from now? The answer to the first two questions would be relatively simple to determine if there was a positive answer to the last one. A man who died with a $10,000 estate in the early 1930's could have provided his family with an income greater than a sizeable portion of the population <u>at that time</u>! Unfortunately, today they couldn't even pay the milk and utility bill with the continuing monthly income from an estate of this size.

One accepted approach to providing a sufficient estate is to start with a comfortable estimate of requirements based on todays' prices, then select some method (or methods) of providing an estate by which inflationary trends will be reflected in estate or income value. In addition, the entire program must be reviewed and kept current to reflect the changes in prices, changes in circumstances, and changes in the economic structure of society.

A young mother with two school-age children will obviously need a larger estate for her lifetime needs than a 50 year old widow with no other dependents.

Factors that enter into the determination of estate requirements are many. There has not been any "magical formula" developed to plug in determinable variables such as: age, number of dependents, state of legal residence, and shoe size, to come up with a valid "target" dollar value.

The determination of estate requirements must be individually determined based on the family size and living standards of the family. The question of "How much do you want your family to have each month to live on?" is not a fair question. A fairly natural reaction is to say, "I want them to continue to live in their present standard-of-living". While this answer is certainly admirable in consideration, a little deeper thought will determine that this is a near impossible goal. The contribution to the standard-of-living by an individual's presence cannot be duplicated, regardless of the amount of a financial estate. Further analysis of estate building will determine that only a limited estate can be provided within the constraints of a military officer's salary and permit a reasonable standard-of-living at the same time.

Guidance on what is a "target" estate value can best be obtained by a synthetic analysis of what the family would do if ...... While the subject is not particularly pleasant, the individual officer does have the obligation to his wife and family to get together and discuss "contingency plans". What would they do? Where would they live? Would (or could) the widow work? What about college for Mike and Susie? Answers to these questions are inputs to the determination of estate planning requirements. The family can better determine what they would do than the officer who would not be present if the "contingency plans" materialized.

The "peace of mind" for the family will be enhanced if they are aware of the situation and have participated in the planning stages. The young mother who only knows that "everything has been taken care of" is all too prevalent and sadly disillusioned. The most important thing has not "been taken care of"! The education of the young wife as to: how much?,when?, where from?,

and actions required on her part (if any) is mandatory! The expression that "God helps those that help themselves" is the rule and not "ignorance is bliss" in this case! Many benefits will never materialize without positive action on the part of the widow. She must be educated on the entire program! The most sophisticated machine in the world is worthless if you can't get it started.

How much monthly income does the widow need to support the family, run the household, enjoy some luxuries, and be moderately comfortable and completely independent? Will she rent a dwelling or are they buying their home with an insured mortgage? Must she provide educational funds or is there a separate program for education? Are there outstanding debts that will decrease the estate? Is there mortgage insurance on the automobile and the furniture? These and similar questions are pertinent to the determination of estate requirements.

Lt. Clever and his wife analyzed their position and family requirements under circumstances that removed him from the scene. They determined that she would need at least $350 per month plus $150 per month for the children. The figures were determined separately as needs are reduced when the children would normally be leaving home or become contributing wage-earners.

Again, it must be emphasized that there is no recognized "formula" for this determination. However, discussions with several officers has supported an opinion that a household could comfortably be maintained for a family with the following income (at all officer levels) and maintain a standard-of-living near that which the family was accustomed to.

Monthly income required =

> 2/3 of Base pay plus $100 for one child, plus
> $50 for each additional child.

This approach may seem distorted at very high incomes (or low incomes) and very large families. However comparison to the "relative" standard-of-

living will place it in the proper prospective.

Lt. Clever's base pay is $565. Based on the above method of calculation, the family needs would have been $376 plus $150 for the children, for a total of $526; decreasing to $476 when Mike becomes 18 years old, and to $376 when Susie is 18.

To reemphasize the point of "individual determination", the previous figure of $350 plus $150 will be used for further estate analysis of this family.

In addition to the monthly requirement previously stated, the Clever family determined that $2000 would be needed immediately for some bills that would have to be settled, some traveling and moving extras that the family would desire to do, and a small "rainy day" fund.

A need for an additional $2000 per year for the years "now + 14" through "now + 20" would be desired for the children's college program if it can be provided at this time. Wilma felt that she and the family could be independently comfortable within these financial constraints.

Lt. Clever next placed the estate requirements that had been determined on a financial estate model as shown in Figure 1, listing dependents ages and years on the horizontal axis and dollar needs vertically to his predetermined goal.

With this requirement model, it was interesting to see how big a "bag full" of money it would take to meet this requirement. By reference to the 1958 Commissioner's Mortality Standard Table, he learned that Wilma is expected to live to be 71 years old.[1] A few calculations determined that his

[1]Institute of Life Insurance, Life Insurance Fact Book 1962, A Report Prepared by the Institute of Life Insurance (New York: Institute of Life Insurance, 1962), p. 110.

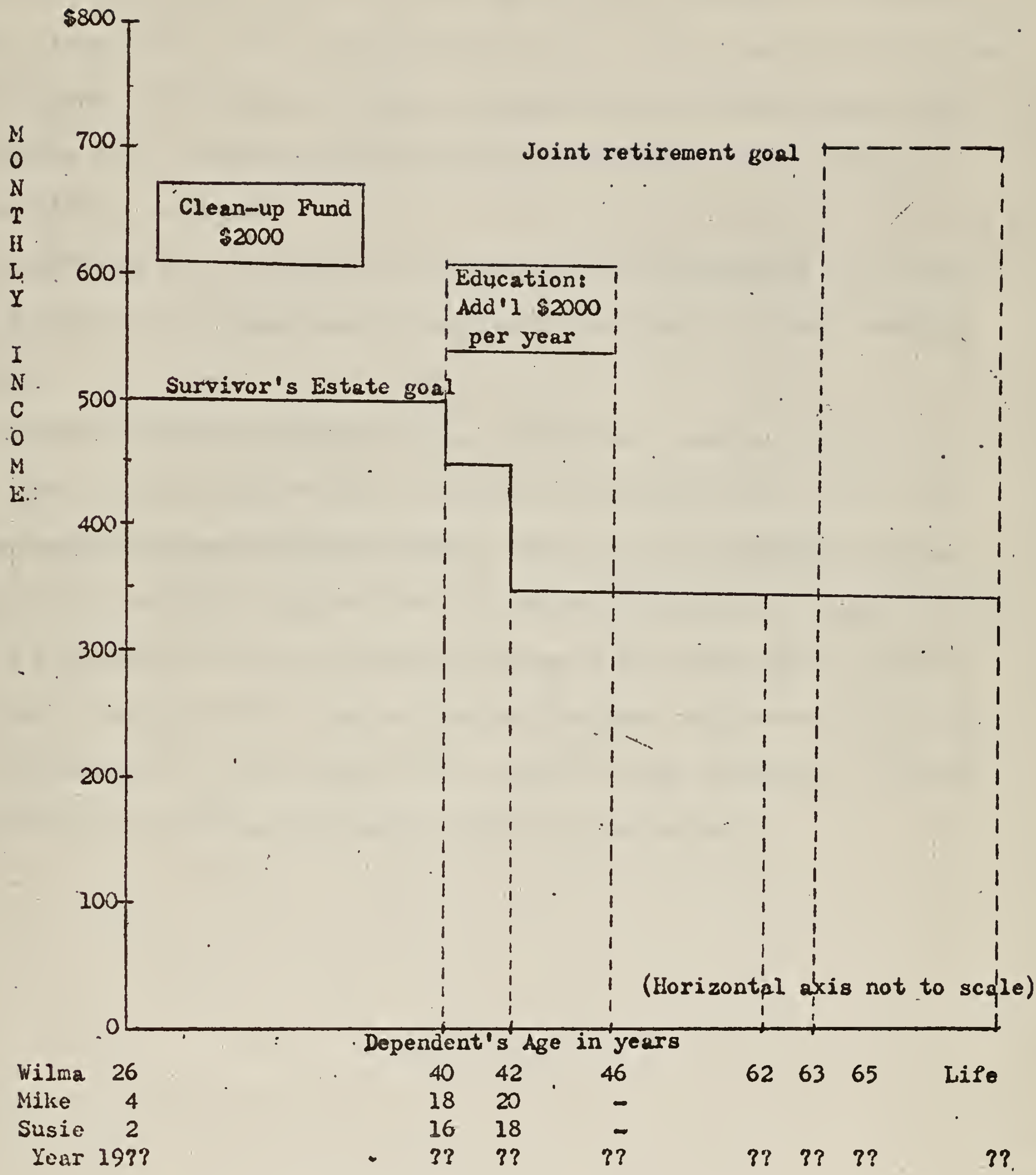

FIGURE 1

FINANCIAL MODEL OF ESTATE REQUIREMENTS
FOR LT. CLEVER'S FAMILY*

*Format from: Dept. of Social Sciences, United States Military Academy, Principles of Insurance and Related Government Benefits for Service Personnel (Harisburg, Pennsylvania: The Military Service Publishing Company, 1953), p. 94.

bag of money would have to contain $326,200. Ten years from now the figure would be $53,800 less. Why not an even $60,000 less? Because a 26 year old woman is expected to live an additional 45 years or until she is 71 years old. When the woman is 36 years old, she is expected to live 36 more years or to be 72 years old. Therefore, there would be an additional year's requirement at $350 per month.

This "money bag" discussion is not particularly significant but it does again demonstrate the importance of continual "updating" of estate planning programs.

During the estate requirement phase, all is not completely morbid. Lt. Clever and his wife looked at the rosy side of the picture also. With the present work force and population trends, they feel that employment for his entire life is extremely doubtful and they do have ambitions of someday "lying under a palm tree and drinking lemonade through a long straw while playing with their grandchildren". They determined that they could have an extremely happy retirement with $700 a month, if it could be made available. This goal was also placed on the estate model to see if it can be met.

CHAPTER III

DETERMINING THE VALUE OF THE CURRENT ESTATE

Now that Lt. Clever has analyzed and determined his "estate goal", he must determine how much of this goal is already provided for. While it is doubtful that any officer is so secure or ignorant of the "financial facts of life" that he does not have some form of commercial insurance or investment program, for this part of the analysis we will only determine the benefits resulting directly from his being a military officer on active duty. Any additional estate contributions will be accounted for in Chapter IV.

Financial contributions to the estate as a result of a "deceased" being on active military duty consist of: (1) a "lump-sum" payment of "six month's salary gratuity" plus a burial allowance provided by the individual service if interment is in a civilian cemetary, (2) monthly income provided for the widow for life (or remarriage) or to children in the event of the widow's death (or remarriage), until the children reach the age of 18 (21 if in attendence at a government approved educational institution). These benefits are provided to survivor's of active military duty personnel under the "Dependency and Indemnity Compensation Act" by the Veteran's Administration.

Estate contributions are also available from the Social Security program. The amount of the contribution is predicated on the survivors' ages and the amount and duration of contributions to the Social Security program. All military personnel are considered "fully covered" for survivors' Social Security benefits although a minimum participation time in the program is required for retirement benefits. The estate can realize a "lump sum" contribution to burial expenses. A monthly income is available for the family providing there are children under 18 years of age. Social Security benefits to

a widow without dependent children are not available under normal circumstances until she reaches 62 years of age.

Six Months Death Gratuity.

A gratuity payment in the amount of six month's base pay (includes hazardous duty pay, if applicable) is payable to the next of kin of a serviceman immediately upon death. Payment normally is made within 48 hours of notification of death and is intended for an "emergency fund". The maximum payment is $3000 and the minimum is $800. This payment is a "lump sum" amount and no option is available for monthly disbursement of this gratuity.[1]

Lt. Clever has a base pay of $565, hence his estate would receive the maximum amount of $3000. The estate of any officer above 0-3 with more than four years of service or <u>any</u> officer with more than two years of service who is also receiving hazardous duty pay would qualify for the maximum death gratuity.

Dependency and Indemnity Compensation.

Under the provisions of the Dependency and Indemnity Compensation Act, the Veteran's Administration will pay to the surviving widow a monthly allowance of $120 plus 12% of the serviceman's base pay (does <u>not</u> include hazardous duty pay) at the time of death. This amount will be paid to the widow during her lifetime or until remarriage and is not contingent on the age or existence of any children.

In the event of remarriage or death of the widow, the Veteran's Administration will provide Dependency Indemnity to children until they reach the

[1]Paid under Public Law 881. (Servicemen's and Veteran's Survivor Benefits Act).

age of 18 or 21 if in school. The amount of this monthly compensation is determined as $77 for one child, $110 for two children, $143 for three children, plus $28 for each additional child. The total amount is equally divided between all eligible children. It is to be noted that the allowance for children is "in lieu of" and not "in addition to" the widow's compensation and would only be applicable in the event of the widow's disqualification.

A Supplemental Dependency Indemnity to children is provided by the Veteran's Administration in the amount of $39 per month for <u>each</u> child attending school in a government approved institution. This is normally paid between the ages of 18 and 21 and is <u>in addition to any other benefits received</u>.

<u>Social Security Benefits</u>.

Under the provisions of the Social Security Act revision effective 1 January 1963, many benefits are available to persons (and their survivors) who are covered by the Social Security program. Military personnel are included in the Social Security program commencing in 1957.

There are many elements of the Social Security program and complete coverage of all elements of the program are beyond the scope of this paper. However, sufficient discussion and factual data will be provided for the purpose of evaluating survivor's and retirement estates as discussed in this paper.

The specific dollar value of the benefits from the Social Security program is dependent on a worker's average earnings (for Social Security purposes) until the time of death or retirement. The determination of this amount may be a little confusing as there have been variable maximum amounts applicable

to this determination for the period 1951 to 1958. Since 1959 the applicable maximum has been $4800 per year.

The calculation of average yearly earnings for servicemen can become quite complicated due to a "retroactive" accountability when servicemen first came under Social Security in 1957, and a provision of the law which states that the averaging years are equal to five less than the total years since 1951 or the years the individual became 21 years of age. A working estimate of average yearly earnings can be determined in the following manner:[2] (use only years after 26 years of age)

1. If on active duty prior to 1957, figure $1920 per year for one year only (1956), regardless of actual pay.

2. If on active duty in 1957 and 1958, calculate actual base pay to maximum allowable credit earnings of $4200 per year.

3. For active duty 1959 and beyond, calculate actual base pay up to a maximum credit allowance of $4800.

By determining average yearly earnings (up to the time of death) by the above method, and entering an appropriate table, we find that for <u>all military officers</u> with over two years of service, the family benefit is the maximum allowable of $254 per month. For 0-1 officers with less than two years service, the family benefit would be $180 per month.[3]

To determine retirement benefits, it is necessary to use a yearly average to the time of retirement. This means that periods of reduced salary or unemployment will substantially reduce the amount of retirement income at age

[2] Harry Jiler (comp), <u>Your New Social Security Benefits</u> (New York: Industrial Relations Institute Division of Commodity Research Publications Corp., 1962), p. 10, 30.

[3] <u>Ibid</u>. p. 13.

65.[4] The monthly stipend received as a result of retirement from the military service is not considered income for Social Security purposes. Unless additional employment, covered by Social Security, is undertaken, retirement benefits will be materially reduced.

The Social Security Act has requirements for minimum time for contributions and maximum lapsed time for a status of "fully and currently insured". All servicemen who die on active duty are considered to be "fully and currently insured" regardless of whether or not they have met the requirements for Social Security coverage. If the actual contributions to the Social Security program were insufficient for qualification, the Veteran's Administration will make equivalent Social Security program payments <u>in addition to</u> any other benefits paid by the Veteran's Administration.[5]

The requirement to be "fully insured" (not "currently") does exist for retirement benefits under the Social Security program, however, all servicemen that retire from the service in the future will be "fully insured" for retirement purposes at age 65. Table I provides an abbreviated benefit table of retirement benefits based on yearly average earnings and retirement age.

The wife (or widow) of a man who is (or would be, if alive) entitled to aged retirement Social Security Benefits is entitled to monthly payments equal to 50% of the husband's benefit (at age 65) if she waits until she is 65 years

[4] As is readily apparent, those persons born between 1898 and 1931 will <u>never</u> receive maximum benefits as the yearly average earnings will always be "diluted" by a maximum figure less than $4800, regardless of income, prior to 1959. All persons born after 1930 must average their income over a period of 39 years for retirement at 65, and "Death age minus 26 years" for survivor's benefits.

[5] Provision of Public Law 881. (Servicemen's and Veteran's Survivor Benefit Act).

TABLE I

RETIREMENT BENEFITS-AGES 62 THROUGH 65*

If the Average Yearly Earnings Were	The Amount of the Monthly Benefit Will Be:			
	If Claimed at 62nd Birthday	If Claimed at 63rd Birthday	If Claimed at 64th Birthday	If Claimed at 65th Birthday or Later
$ 800	$ 32.00	$ 34.70	$ 37.40	$ 40.00
1,200	47.20	51.20	55.10	59.00
1,800	58.40	63.30	68.20	73.00
2,400	67.20	72.80	78.40	84.00
3,000	76.00	82.40	88.70	95.00
3,600	84.00	91.00	98.00	105.00
4,200	92.80	100.60	108.30	116.00
4,800	101.60	110.10	118.60	127.00

*Jiler, op. cit., p. 14.

of age before she starts drawing benefits. However, she may elect to draw 75% of this amount from age 62, 83 1/3% from age 63, or 91 2/3% from age 64.[6] The once established amount would be available for life and is in addition to any Social Security benefits the husband may be drawing. In addition, if the husband should die after she has elected any reduced retirement payment, she would then commence drawing the "widow's benefit" as listed in Table II in lieu of the previous amount.

The Social Security Act also provides for a "lump-sum" death payment to assist in defraying the burial expenses. This is basically a sliding scale but all military officers would be eligible for the maximum benefit of $255. It might be added, however, that this benefit is presently contingent on the existence of a "body" to dispose of. A "not recovered" or "lost at sea" death is presently ineligible for the $255 Social Security lump-sum benefit.[7]

[6] Jiler, op. cit., p. 16.

[7] "The Funeral Industry", (Consumer Reports, XXX (June, 1965), p. 84.

TABLE II

MONTHLY BENEFITS FOR SURVIVORS OF W[illegible]KERS
INSURED BY SOCIAL SECURITY*

If the Average Yearly Earnings Were	Widow (age 62) Collects Monthly	Widow, and one child Collects Monthly	Widow, two children Collects Monthly	Lump-sum Death Payment
$ 1,200	$ 48.70	$ 88.50	$ 88.50	$177.00
1,800	60.30	109.60	120.00	219.00
2,400	69.30	126.00	161.60	252.00
3,000	78.40	142.60	202.40	255.00
3,600	86.70	157.60	236.40	255.00
4,200	95.70	174.00	254.00 (max)	255.00
4,800 up	104.80	190.60	254.00	255.00

*Jiler op. cit., p. 21.

The Existing Financial Estate.

Lt. Clever now is in a position to place the various amounts of the existing estate on the estate model started in Figure 1.

Lt. Clever's estate would receive the maximum amount of $3000 for the "six month's death gratuity". In addition, the estate may realize the amount of $255 from the Social Security lum-sum death payment. This amount adequately covers the proposed requirement of $2000 previously determined.

A monthly payment from the Veteran's Administration is available to the surviving widow for life in the amount of $120 + (12% x $565 (Lt. Clever's base pay)), which equals $187.80. For convenience we will use round figures and enter this amount in the estate model as $188. Note that this amount will change with each change in base pay.

The estate contribution from the Social Security program is dependent on the average yearly earnings. Calculation at any time in the future may yield higher amounts if it is necessary to use years of less than $4,800 per year.

Lt. Clever was born in 1936. By using the calculation method previously discussed, he need only average his wages since 1962 (the year he was 26 years old). He determines his current average yearly earnings for Social Security pruposes to be $4,800. This figure will continue to be $4,800 unless his income drops below that for more than three years in the future.

By entering Table II with the figure of $4,800 for yearly earnings, Lt. Clever determines that a monthly income of $254 is available to his family until Mike is 18 years old, then $191 ($190.60 to be exact) until Susie is 18. All Social Security benefits will stop when Susie is 18 years old. When Wilma is 62 years old, she will be eligible for the widow's benefit of $105 ($104.80) for life. These figures are entered on the estate model in Figure 2 as "existing estate funds".

The desired education fund requirement can be reduced by the amount of $39 per month per child that is attending college. This amount is provided by the "Supplemental Dependency to Children" from the Veteran's Administration. This can be simply calculated as:

$$\frac{\text{36 months x \$39 x 2 children}}{\text{6 years}},$$

which contributes an average of $468 per year to the educational fund.

The current estate model is shown in Figure 2.

Retirement Estate.

Lt. Clever feels certain that the worst he can do in a military career is to retire from the service as a Commander (0-5 pay grade) with 26 years of service. Retirement under these conditions would allow him a retirement pay

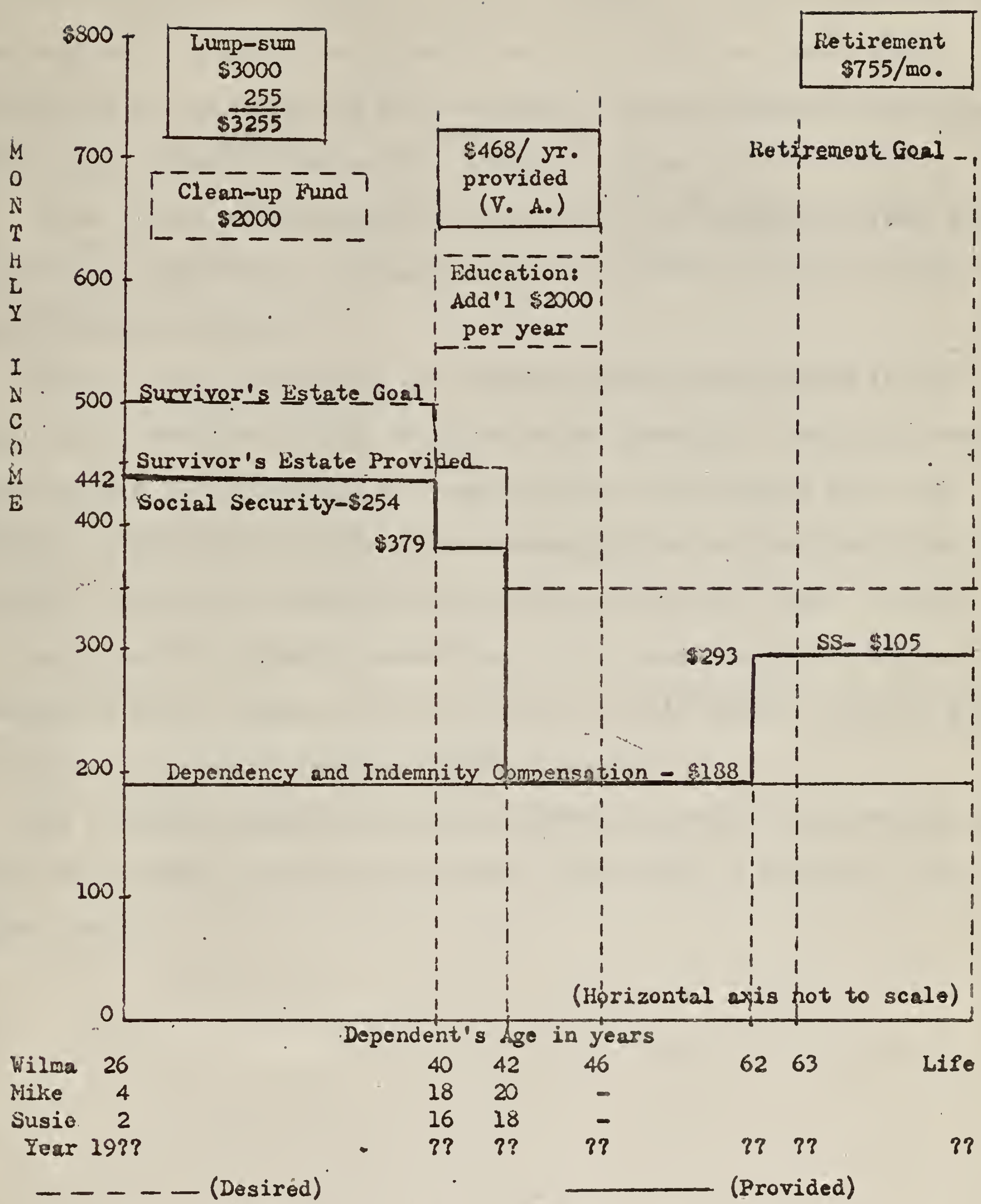

FIGURE 2

FINANCIAL MODEL OF CURRENT ESTATE
FOR LT. CLEVER'S FAMILY

of $575 per month from age 46.[8] If he can continue to earn (as employee or self-employment contribution to Social Security) $4,800 per year, when he reached age 65, he would draw $127 from Social Security (Table I), and Wilma would draw $53 (Age 63) for a total retirement income of $755 per month.

If Lt. Clever should remain on active duty for a complete military career of 40 years, his military retirement pay would be $926 per month plus any Social Security benefits.

Now Lt. Clever can analyze the financial discrepancy between the "desired estate position" and the "existing estate position". Using the "money bag" analysis, he has reduced the required value of the "money bag" from $326,000 to $64,417. Lt. Clever's present estate has the long term value of $261,703. Rather than letting every military officer feel like a "quarter of a millionaire", it must be pointed out that "present value" of the dollars forthcoming in the analysis 40 years from now is only about $ .20. The growth, of course, is caused by compound interest functions.

The following chapter will discuss methods to provide the difference between the "desired" and "existing" estate, <u>and</u> methods of building a "cash value" estate.

[8] Retirement pay would be less by any contribution to the "Retired Servicemen's Family Protection Plan" (formerly Contingency Option Act). However, if proper estate planning is accomplished at an early age, the plan is unnecessary for family protection.

CHAPTER IV

BUILDING THE ESTATE TO MEET REQUIREMENTS

Lt. Clever now has the problem of analyzing his estate shortages and providing sufficient funds by his own procurement of insurance, investments, or savings to provide the difference between the "funds required" and "funds provided" in Figure 2.

As was previously stated, one way to meet this requirement is to provide a sum of money equal to $64,417. By subtracting the monthly shortage of the funds already provided each month, the fund would be empty if Wilma dies as predicted at age 71. One method of providing this amount of money is to buy $65,000 worth of life insurance. This amount of insurance could be purchased by a 28 year old male for approximately $200 per year by known combinations of term and group term insurance available today.

Common sense, however, will indicate that this sum can be considerably reduced by receiving some interest (no matter how small) on those funds not immediately needed. Secure savings are available in many forms earning interest rates from 3% to 4½% compounded semi-annually. Interest rates available vary considerably based on current economic trends of the society. At a compound interest rate of 3½% for each dollar that is needed in the 45th year of the estate plan, only $ .26 need be provided at this time.

An annuity is a method of providing periodic payments for a period of time from a given amount of money. Withdrawals are made from a fund to make periodic payments, however, the remainder of the fund is continually earning compound interest. Annuities can be purchased from various sources or can be established by an individual.

Using annuity analysis, Lt. Clever can provide all funds necessary to meet the estate deficiency by having only $40,889 available for deposit. The amount remaining after the periodic withdrawals would continually earn interest and allow the fund to last for the entire period covered by the estate plan.[1] (This calculation was made using an interest of 3½% compounded semi-annually. This selected criteria is considered reasonable based on current interest trends.) Lt. Clever can purchase $50,000 worth of term life insurance for as little as $150 per year if he should elect this method of providing his current needs.

A solution to the immediate problem for the family security estate is relatively simple. A look into the future is necessary to foresee possible difficulties for future estate revisions. A change of occupation would completely change the estate plan in the future as a greater portion of the present plan is based on benefits resulting from the present occupation of active military service.

Lt. Clever previously used a situation of possible retirement from the service at age 46. If he should retire at that time, the amount of $188 per month from the "Dependency and Indemnity Compensation" would be missing. This would place a sizeable instantaneous burden on the estate if he were to die. A little foresight can prevent either a sizeable estate gap or an unnecessary large expenditure for insurance from the "Retired Serviceman's

[1] Present Value and Annuity Tables for calculation of various plans are included in any collection of "Mathematical Tables". Present Value tables are also normally included as an appendix to any textbook on financial subjects.

Family Protection Plan" or commercial enterprises.[2] Using present value of an annuity from the time Lt. Clever is conceivably retired at 26 years of service, his self-provided estate would then have to be approximately $68,610. Providing an insurance policy of this size is much more costly at 46 years of age than at an earlier age.

Other things to be considered as a long range view is the income upon retirement. An income of $755 per month was used for retirement analysis, but 46 years of age is a long way from retirement. With current population and employment trends, employment at that age may be difficult if not impossible to obtain. An additional income would most assuredly solve many potential problems. Additionally, for any years that employment income for Social Security purposed falls below $4,800, the value of the widow's pension at age 62 is reduced, thereby placing an additional requirement on the estate.

What about the education fund? A requirement for $2000 per year for six years was determined. This amount was also provided for in the event of father's death. The same amount is needed for education if he lives! Early recognition of the known elements of future requirements can make estate planning more meaningful.

Lt. Clever recognizes and considers these possible problems in seeking to build an estate. While the immediate problem is providing a means of satisfying the family needs if he were to die tomorrow, he also recognizes other conceivable (and more pleasant) situations which will influence present decisions and actions regarding estate plans.

[2] George Marker, "Family Annuity Plan Defended by Expert," Navy Times, June 9, 1965, p. 30.

The immediate problem for estate security can be solved for as little as $150 per year. This, however, does not consider any provision for the educational fund, a supplementary income in the event of early retirement from the service, or an additional estate requirement for the survivor estate after retirement.

There are many ways to build a cash or income producing estate. All of them require some monetary contribution. How much money is necessary per month or year to build an adequate estate to meet any foreseeable needs? This depends on the methods of building the estate that are used. The amount could be an astronomical figure! With a little luck and a crystal ball, it could also be a pittance.

A more reasonable questions is, "How much can I afford?". Here again, a personal, individual determination and decision is necessary. If we live in a tent and eat beans and hamburger, we can afford to allocate the greater portion of income to estate building. Chances are good, however, that those making the sacrifices would never receive the benefits.

There is no formula figure for estate provision. Interviews with insurance agents elicits a guiding figure of 11% of salary. Stock brokers and fund advisors place the figure as arbitrary based on "marginal value" of all income and a provisioning hierarchy of the elements of estate planning and normal living expenses. The savings bank motto of "pay yourself first" has frequently used a relative figure of 10% of income to savings. Many people, however, use a "what's left over" approach. As there is never any "left over", there is never any estate building and they find themselves on relief or in serious difficulty in later years.

Lt. Clever decided to religiously use $70 per month on his present estate building plans and try to add 50% of any pay raises he might receive.

He feels that his family can comfortably live within the remainder of the income constraints. With this amount available regularly, he will analyze the methods of estate building available, and by a mixture of possibilities, attempt to meet his personal requirements and goals.

I. ELEMENTS OF ESTATE PLANNING

There are many methods available to utilize a given amount of money for estate building. These methods might range from the most secure at one end of the spectrum of "burying cash in the ground", to buying stock in "the first tortilla factory on the moon" at the other extreme. In one case there is little chance of physical dollar loss, however, with the inflationary trends in dollar purchasing power, the future purchases with these dollars will be considerably less than at the time of the saving. At the other extreme, if the tortilla factory does succeed, the possible return on investment could make one a "millionaire". The chances of becoming wealthy by either method are very small indeed.

The prescribed criteria for utilizing limited funds for estate building is on the basis of: (1) protection, (2) savings, and (3) investment.[3] Mr. Arthur Weisenberger, a nationally known investment counselor and a member of the New York Stock Exchange, says that money should be placed in the following order: (1) Life Insurance, (2) Savings banks, (3) Government bonds, and (4) Investment Companies or Stocks.[4]

[3] Phillip J. Goldberg, Estate Planning (New York: Oceana Publications, Inc., 1960), p. 10.

[4] R. C. Allen, The Truth About Life Insurance (Louisville, Kentucky: Insurance Reporting Service, 1962), p. 21.

The hierarchy of money placement is in exact agreement with the criteria for placement and involves a priority assignment to amounts of money from limited investment funds.

The exact expenditure of funds available is determined by the priority of the money available for allocation. If there is sufficient life insurance to cover the estate requirements in the event of death, the next achievement goal should be a provision for readily available money in a savings account, preferably earning the highest interest rate available consistent with security. This saving is financial protection for unforeseen expenses caused by sudden illness, emergency leave, or when Susie trots home from the dentist and announces that she is going to need braces. Various amounts of savings have been recommended, but the most prevalent opinion is that "two months salary" is considered an adequate savings.

Mr. Weisenberger, undoubtedly feels that the security inherent in government bonds (at a guaranteed interest) far outweights the risk for the opportunity of higher returns on stock investments.

Another accepted approach for estate building is a programmed mixture of guaranteed investments from stocks and an acceptable risk and potential substantial growth on stock investments; a "not all eggs in one basket" approach.

The appropriate application of limited funds is, of course, dependent upon the priority of money available and the purpose for which its application is intended. Life insurance is not normally thought of as an investment to educate the children, but in some cases it may be the ideal way of guaranteeing the necessary funds in the event of an untimely death before the fund goal is achieved.

An analysis of the various investment outlets, the advantages and disadvantages, and the results obtainable from application of funds is necessary for the proper allocation of limited funds in the attainment of an estate goal.

II. LIFE INSURANCE

The Insurance Principle

The principle of insurance is nothing more than cooperative sharing of the cost of loss among those subjected to the risk of loss. A simple example of life insurance would be where insurance was desired for one year and all those desiring to be insured were of the same age. An agreement could be reached among the insured that a specified amount of insurance would be paid by making an assessment on each member whenever a death occurred. This would be "assessment insurance", a plan which has obvious practical limitations.[5] If the insurance in question were provided by a life-insurance company, the company would charge each person insured a premium, payable in advance, based on the probable cost of the insurance as indicated by past experience. If the premium proved to be more than sufficient (which has been the case in recent years with the death rate continually decreasing), the excess amount would be refunded to the insured in the case of Mutual companies, or paid as dividends to stockholders in the case of Stock companies.

Basically, insurance is a statistical "gamble" on the risk of dying within the period for which insurance is in effect. While gambling is generally considered detrimental to the economy as a whole, the gamble involved by in insurance principle is considered good for the economy.[6] Insurance

[5] Joseph B. Maclean, Life Insurance (New York: McGraw-Hill Book Company, Inc., 1962), p. 7.

[6] Paul A. Samuelson, Economics, An Introductory Analysis (New York: McGraw-Hill Book Company, 1964) pp. 421-22.

companies, in general, are a stabilizing influence on the economy. In addition, they control greater amounts of assets (mostly monetary rather than physical) than any other single business in our society. This alone is a responsibility not to be handled carelessly. Careless policies on the part of some of the larger companies could cause complete collapse of a growing economy for a short time. Think about the effects that could result from careless handling of the Metropolitan Life Insurance Company's assets of approximately $20 billion.

Life Insurance Companies.

There are two kinds of insurance companies involved in selling life insurance: Stock companies and Mutual companies. Stock companies are more prevalent than Mutual companies in the United States and Canada. A Stock company is owned and controlled by its stockholders who also receive the company profits as dividends. Mutual companies have no capital stock and no stockholders. They are purely cooperative associations of the insured (policyholders) who own the company and control the operation through their right to elect directors.[7]

It would appear that Mutual companies may offer more benefits to the policyholders than Stock companies by "participating" in the company operations and profits. Actually, "participating" policies are available from Stock companies and "non-participating" policies are also available from mutual companies. Many factors, such as the economy and efficiency of management, size of assets, number of policyholders, etc., affect the cost of insurance to policyholders. It should not be assumed that because Stock companies

[7] Maclean, op. cit., p. 340.

are organized for stockholder profits, that insurance and benefits will necessarily cost more than in a mutual company.[8]

Of the 1,457 Life Insurance companies in business on June 30, 1961, 1,301 were owned by stockholders and 156 were Mutual companies. The Mutual companies, usually older and larger, accounted for three-fifths of the total life insurance in force.[9] Because of legal requirements and other practical difficulties, it is now virtually impossible to organize a new company on the mutual plan.[10]

As is the case with any group of businesses, there are reliable insurance companies and occasionally an unreliable one. There are large companies and relatively small ones; efficient companies and inefficient ones; and most important, expensive and relatively inexpensive ones. Some companies may offer inexpensive programs but be on a "shaky" financial platform. The value of insurance to a policyholder is little if the company is disestablished. The "cheap" insurance could prove very costly.

Several readily obtainable publications will list the insurance companies by size, reputation, age, etc., and in many cases give relative recommendations. It definitely behooves the future policyholder to investigate the company with which he is contemplating insurance. If the agent is reluctant to show the company rating in some current rating publications such as Best's Insurance Guide with Key Ratings, it might be wise to select a different company.[11]

[8] Ibid.

[9] Life Insurance Fact Book 1962, op. cit., p. 98.

[10] Maclean, op. cit., p. 341.

[11] Best's Insurance Guide with Key Ratings (New York: Alfred M. Best Company, Inc., Annual Publication); and William J. Matteson and E. C. Harwood, Life Insurance and Annuities from the Buyer's Point of View (Great Barrington, Mass: American Institute for Economic Research, 1955), pp. 45-50.

Types of Life Insurance Policies.

Although the basic principles of life insurance are relatively simple, the many different types of policies that are available may be confusing. It is important that the selection of any particular type of policy be based on actual need and the policy's ability to meet the need, rather than included "gadgets" or reduced sales resistance.[12]

A life-insurance policy is a legal contract between the insured and the insurance company. According to law, the policy must contain the entire agreement. The wording is necessarily quite detailed, however, the meaning is intelligible if a genuine effort is made to understand the stipulations of the policy.[13] Regardless of the agent's promises, if the situation is not written in the policy, you will not receive the benefit!

Basically there are four different types of life-insurance policies: (1) term insurance; (2) straight life or "ordinary" life insurance; (3) limited-payment life insurance, such as 20-payment or 30-payment life; and (4) endowment insurance.

Term Insurance.[14] Term insurance is insurance for a certain period only, usually from one to 20 years. Some companies will issue term insurance that remains in force until the policyholder reaches a specified age, 60 or 65. The premium for term insurance is determined on the policy-holder's chance of dying during the period of the "term". The insurance may be renewable (at a higher rate calculated on the increased mortality rate of higher

[12]William J. Matteson and E. C. Harwood, Life Insurance and Annuities from the Buyer's Point of View (Great Barrington, Mass.: American Institute for Economic Research, 1955), p. 15.

[13]Ibid.

[14]Ibid., p. 16.

age), or convertible to other types of policies. Term insurance premiums are determined solely as "pure insurance" costs. The policies have no cash or loan value, receive no dividends, and expire at the end of a specified "term" or period. In that insurance is more costly with age, term insurance policies are normally constant premium with decreasing insurance coverage, or a fixed amount of insurance with increasing premiums with age. The premiums on term insurance are generally considerably less than premiums on other types of insurance, however, the benefits are also more restricted. Term insurance is best suited only to provide for temporary needs.[15]

<u>The Straight Life Policy</u>.[16] The most common type of life insurance is the straight life policy. The policyholder agrees to pay a specified "level" premium for life, and the company agrees to pay a stipulated amount at the death of the insured. The premiums are based on the aggregate cost of a series of "terms" reduced to a single "level" premium throughout the entire paying period. During the younger years, the premium is in excess of the actual cost of insurance and a "reserve" is accumulated for the later years when the actual cost would be much greater than the level premium. The reserve fund, however, earns interest and further reduces total insurance costs. As the policyholder may not elect to keep the policy for life, some of the "reserve" is utilized to provide a "cash value" to the policy in the event of cancellation. "Participating" policies also provide dividends to the policyholders as a result of company profits. The cash value of a straight life policy normally accumulates at a rate which would allow the policy to build to "face value" at the highest age included in the mortality table (presently

[15]Matteson and Harwood, <u>op</u>. <u>cit</u>., p. 16.

[16]<u>Ibid</u>., p. 17., and Maclean. <u>op</u>. <u>cit</u>., p. 22.

100 years). This means that the policyholder who kept a straight life policy in force would receive face value when he was 100 years old.[17]

Some people argue that the straight life policy is in fact a decreasing term policy on which a higher premium than necessary is being paid. The reasoning is that if the policy has a cash value if surrendered, only the difference between face value and cash value is the benefit in the event of death. While the interest earned on the reserves and cash value are payable in the form of dividends, the guaranteed interest rate is normally stipulated at 2-2½% (low by today's market standards). During recent years however, some companies have been paying interest rates of 4% or better. The logic of this argument may deserve some consideration during a final estate plan decision.

If the policyholder discontinues the payment of premiums on an ordinary life policy, several choices are available to him: (1) he can receive the cash surrender value and terminate the insurance; (2) he can convert the contract to whole-life paid-up insurance for an amount less than the face amount of the original policy; or (3) he can have the same amount of insurance continued as term insurance for a specified period.[18] Generally a ten year old policy purchased at 26 years of age can be surrendered for paid-up term insurance for about 22 additional years.

Limited Payment Life Insurance. Under a limited-payment policy, the insured pays a premium only for a stipulated period (usually 20 or 30 years). The policy then remains in force the remainder of the insured's life. The

[17]Maclean, op. cit., p. 26.

[18]Matteson and Harwood, op. cit., p. 17.

premiums are necessarily higher than that of a straight life policy because the payment period is shorter. The reserve accumulates faster and the cash surrender value is also larger than that of an ordinary life policy. Other aspects of the policy are the same as those of straight life policies.

Endowment Insurance.[19] For an endowment policy, the policyholder pays a fixed premium for a specified "endowment period" of time. During that time period he is insured for the face amount of the policy. At the end of the period, he receives the face amount in cash and the insurance ceases.

Endowment premiums are necessarily higher than for any other type of life insurance. The chief justification for endowment insurance is that it provides a convenient method of saving for those individuals who would not save otherwise. The financial security of most life insurance companies appeals to some people in spite of the low investment yield.

Group Insurance.[20] Group Insurance is a method by which an insurance company underwrites an entire "group" instead of each individual life. The members of the group normally have some common characteristic so that calculations of risks for each individual become very small. A group may consist of a specific company's employees, Federal Service workers, non-drinkers, etc.

Normally each group is underwritten on a basis which appears to be self-supporting. Ordinarily no medical examination is required, however, experience has shown that the rate of mortality among persons insured under group contracts to be very low. By issuing only one policy, the underwriting company can reduce administration costs to practically nothing. The "group"

[19] Matheson and Harwood, op. cit., p. 19.

[20] Maclean, op. cit., p. 370.

sponsor then must perform the individual policy administration and premium collection from the individuals.

Several organizations offer "group term insurance" to a "military personnel" group. Because of the exceptional physical condition of military personnel in general, the mortality rate is much below the average population and is reflected in the very low relative premiums. $20,000 of group term insurance for military personnel is offered by one organization for as low as $75 per year for the 25-29 year age group.

Double Indemnity Clauses. Some policies offer a "double indemnity" clause for a small additional premium. This means that the company will pay double the face value of the policy if the insured's death is due to accident or injury. Accidental-death benefits are not inexpensive, as the chances of dying in the exact manner necessary to collect the double payment are small.[21] In addition, most double indemnity provisions exclude deaths as a result of an act of war or of travel on, or flight in, military aircraft while on duty.[22] This exclusions makes the double indemnity provision unattractive to most military personnel.

Over and above the unattractive exclusions of the double indemnity clause because of military duties, the method of death can in no way be related to the family needs. The additional premium for "double indemnity" can be better applied to more guaranteed insurance.[23]

[21] Matteson and Harwood, op.cit., p. 8.

[22] Dept. of Social Sciences, United States Military Academy, Principles of Insurance and Related Government Benefits for Service Personnel (Harrisburg, Pennsylvania: The Military Service Publishing Company, 1953), p. 50.

[23] Maclean, op. cit., p. 80.

Establishing Insurance Premiums.

The mathematics of the exact computation of insurance premiums become quite involved and is not presented as part of this paper, however, the inputs into the determination of premiums deserve some discussion. Basically, the premium is based on the face value of the policy times the risk of the insured dying during the period covered by the policy. The risk, of course, is dependent on age and is generally the ratio of: $\frac{\text{number of people dying at each age}}{\text{number of people living at each age}}$. This ratio is determined for all ages for the life of the policy. Other variables necessary is the "present value" of dollars, particularly those which will be future payments, plus the additional probability that the insured will survive to make the payments. The interest figure necessary to determine "present value" varies slightly between companies. Since 1960, all companies have used the identical mortality rates from the "Commissioner's 1958 Standard Ordinary Mortality Table" (1958 C.S.O. Table).[24] The previous table was of 1941 vintage. In that mortality rates are constantly decreasing with improvements from medical research and sanitary conditions, the costs of insurance is decreasing. This is reflected in the downward trend of insurance rates and in the dividend payments received by the policyholders of "participating" policies.

Finally, the premium is "loaded" with a fee to cover the company's administration expenses. This "loading" is usually a percentage of the level premium plus some fixed amount. The load fees can vary considerably with each company and explain the premium difference for identical policies from different companies. The efficiency of management policies is also reflected

[24] Ibid., pp. 72-72.

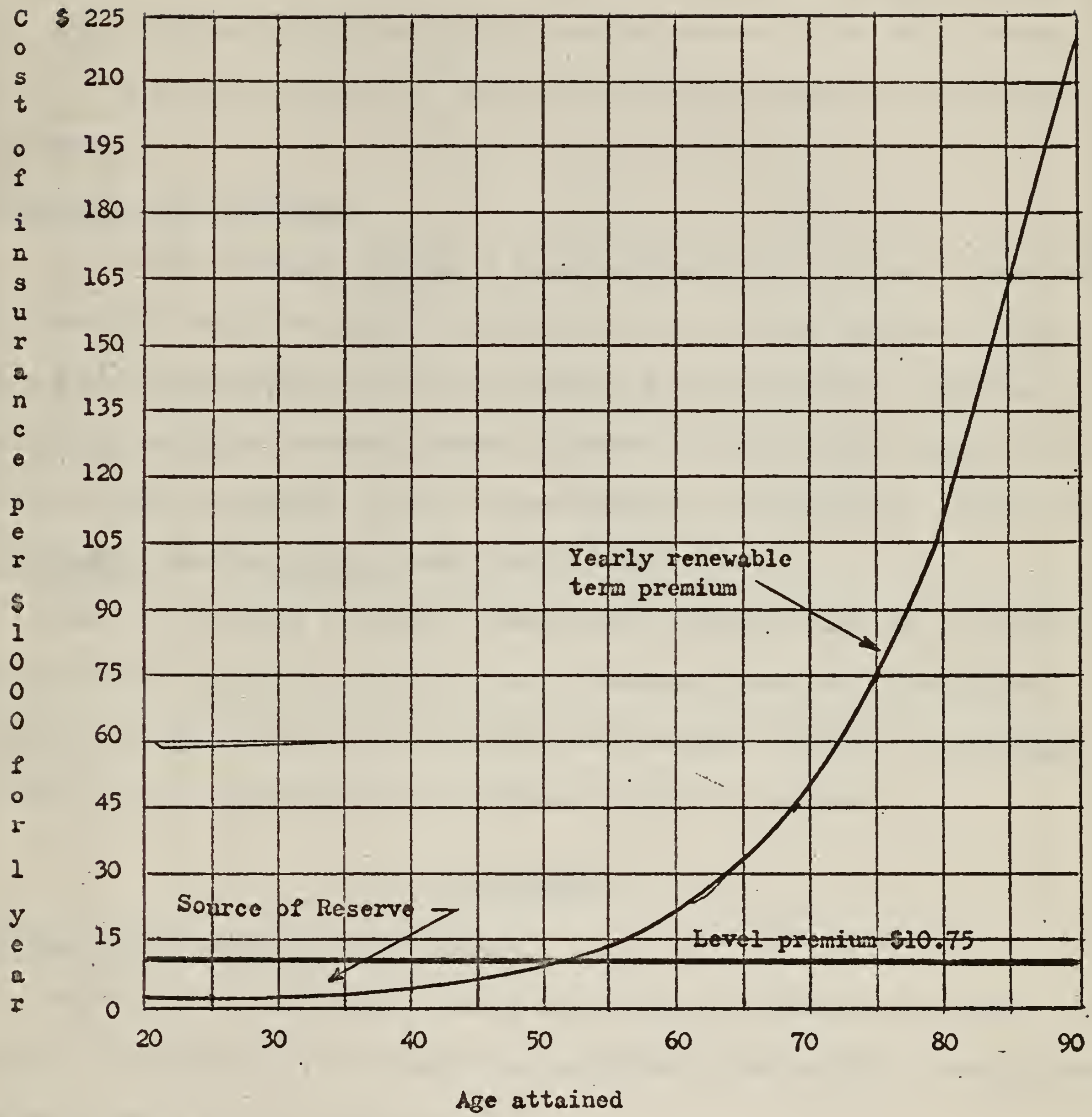

FIGURE 3

COMPARATIVE COST OF INSURANCE ON LEVEL-PREMIUM AND RENEWABLE-TERM PLANS*

(Age at issue twenty; amount of insurance, $1000)

*Maclean, op. cit., p. 17.

in the "participation" benefits received.

Figure 3 shows the comparative cost of term insurance at various ages, the level premium for the same period, and the source of the policy reserve fund. The specific values will vary with different companies as previously discussed.

Purchasing Life Insurance.

If a life insurance program is being contemplated, it is most important to carefully select the type of insurance and the company involved. Each policy can meet specific needs not available by other methods. Each has a price and successful estate planning dictates that each dollar spent contributes as much as possible to the accomplishment of estate goals. Paying for unnecessary benefits is not sound planning policy.

Table III on page 36 shows a comparison of various types of insurance policies with respect to protection and investment features. The figures represented in the table will vary with each company, however, the relative benefits can be analyzed for the different types of insurance.

III. INVESTMENTS

Purpose and Principles of Investments.

The two main reasons most people invest are to obtain income (either for current or later use) and to enjoy the opportunity for profit or capital gain while assuming the risks involved.[25]

The Mutual Fund Newsletter in its issue of October, 1959, outlines the basic considerations of a successful investment program.[26] These considerations

[25] Arthur Weisenberger, "The Modern Way to Invest" ([n.p.]: Arthur Weisenberger & Company, 1961), p. 7. (Pamphlet)

[26] Philip J. Goldbert, Estate Planning (New York: Oceana Publications, Inc., 1960), pp. 50-53.

TABLE III

PROTECTION AND INVESTMENT PROVIDED BY VARIOUS TYPES OF POLICIES*

Policy type[a]	Annual Premium Rate per $1000 of Insurance (Age 23)	Amount of Insurance Purchased by an Annual Premium of $100	Cash Value at Age 60 per $100 of Annual Insurance Premium	Monthly Income at Age 60
Term (5 Yr. Conv.)	$ 6.99	$ 14,308.00	None	None
Ordinary Life	19.12	5,230.00	$ 2,939.00	$ 16.46
20 Payment Life	30.80	3,247.00	2,390.00	13.38
Endowment at Age 60	25.58	3,909.00	3,909.00	21.89

[a]Dividends have been disregarded in the computation of the above data

*Dept. of Social Sciences, United States Military Academy, Principles of Insurance and Related Government Benefits for Service Personnel (Harrisburg, Pennsylvania: The Military Service Publishing Company, 1953), p. 28.

are: (1) Safety, (2) Income, (3) Growth (4) Diversification, (5) Selection, (6) Supervision, (7) Marketability, (8) Regularity, (9) Compounding, (10) Opportunity, (11) Flexibility, and (12) Improvement.

Each of the items listed are worthy of consideration. Unfortunately, items such as "selection" and "supervision" are not able to be given the attention they deserve by a military officer while in his pursuit of military duties. As a result, some methods of investment are more appropriate than others for utilization by the military officer. The more common (and appropriate) methods for investment by military officers will be discussed. The absence of any particular investment opportunity does not imply that they might not be superior to those listed, however, many investments, such as real estate, require almost constant personal supervision to receive the full investment benefit. This requirement is not normally compatable with a military career due to frequent duty relocation.

Selected Investment Opportunities.

The career dedication of the successful military officer considerably influence his available time, location, and available funds for investment. These factors place more constraints on the selection of investment methods than is normally encountered. An understanding of the methods available and proper selection can provide the desired benefits of growth and income for the careful investor.

The potential growth and benefits from investments, of course, are in proportion to the "risk" of failure. At some combination there is an acceptable balance for every investor. Low yield (or income) rates are available with little or no risk such as the "bond" market. At the other extreme, some "lucky" individuals have become quite wealthy by an original investment

in "high risk" stocks.

Three methods of investment are presented for the consideration of a military officer's investment program. The ultimate selection or "mixture" will, of course, be an individual choice based on personal values.

Bonds.[27] The sale of bonds is one method that corporations (or governments) have to obtain outside capital for a long period of time.

The purchase of a bond entitles the holder to: (1) its face value at the end of a stipulated period of time, and (2) interest payments at regular intervals at a specified rate which remains unchanged for the period of the loan. Payment of interest and principal is not contingent on the company's earnings, however, if the company should go bankrupt, the bond may be nearly worthless. The initially promised interest is governed by the prevailing interest rates available adjusted for any risk factor necessary to make the bonds attractive enough to sell. Government or Municipal bonds have lower (but reliable) interest rates than corporate bonds. On the other hand, some tax relief is available for income received from certain types of government issued bonds.

Bonds are bought and sold in the same method as stocks. The price of the bond will fluctuate from the face value of the bond to yield the current market interest rate for such bonds. As bonds near their maturity date, the price tends to equal that to be paid by the issuing company on redemption, since the holder must accept repayment and receives no more interest.

Bonds have about the same advantages as stocks as to convenience, marketability, and freedom from time-consuming management. Bond markets are listed

[27]Thomas E. Babson and David L. Babson, Investing for a Successful Future (New York: The Macmillan Company, 1961), p. 114.

with the New York Stock Exchange and transactions can be arranged by any broker.

Bonds are considered the most secure type of investment with a proportionally low investment yield.

Stock Investments. The purchase of a company's stock is a purchase of a proportional share of the company's assets, earnings, and obligations. If a company was organized initially with $1,000,000 financed by selling 10,000 "shares" of stock at $100 each and today the company was worth $2,000,000, each share would be worth $200 (or more). A substantial "growth" is demonstrated in this example. In addition, if earnings produced a "dividend" of $20 per share, this would further escalate the market value of the stock to where the "dividend" need only be an acceptable return for the proportional investment commensurate with the risk.

The other aspect of the stock investment picture also must be considered. If the company does not grow, and does not make profits allowing dividends, the value of each share can become nearly "worthless" and unmarketable. Stocks with little growth potential and small likelihood of dividends are understandably unattractive. A savings account earning 3% is a wiser choice.

Some companies pay small dividends but reinvest profits for company growth. Stocks of this type are wise choices for the purpose of investment "growth". Other companies pay sizeable dividends and are obviously better choices for "income" investment. Each stock will have its own "personality", purpose, and potential.[28] A basic understanding of stock categories will aid in preventing poor investment decisions.

[28] Babson & Babson, *op. cit.*, p. 132.

Common Stocks. "Common Stock" is the basic security issued by a corporation. The stockholders are eligible to share in the company's growth (or loss) and profits after company obligations of a higher priority. The common stockholders have a vote in the management policies of the corporation with a weight based on the percentage of ownership. A wise selection of "common stock" purchases can provide growth and income for estate planning purposes.[29]

Preferred Stock. "Preferred Stock" represents an ownership interest in a company and usually is entitled to a fixed dividend. Preferred dividends must be paid before the common stockholders get their cut of any earnings. The price for the preferential treatment is that the preferred stockholders cannot share in the company's prosperity beyond a stipulated amount. The preferred stockholder is usually without a vote in the affairs of the company except in matters having a bearing on the preferred stockholder's interest. It is conceivable that if enough preferred dividends were omitted, the preferred stockholders might take over control of the company.[30]

"Blue Chip" Stocks. The term "blue chip" is commonly used for common stock of high security and reliable dividends. The term is associated with companies known nationally for the quality and wide acceptance of its products or services, and its ability to pay dividends in good times and bad.[31] (Example: American Telephone and Telegraph Co.)

[29] Henry Gellermann, How to Make Money Make Money, (New York: Thomas Y. Crowell Company, 1957), pp. 45-46.

[30] Ibid., p. 46.

[31] Ibid., p. 281.

Mutual Funds. Investment in Mutual Funds is one method by which the investor can ensure himself that the dozen considerations for successful investment are being met. A Mutual Fund share is simply a "share" of a "bag of money" that is reinvested in the various and sundry methods available to "make money with money". The Fund shareholders share in the profits (and occasionally losses) and growth of the entire Fund program.

Mutual Funds, by their very nature, achieve a higher relative security by "diversification" than a single stock would. The Fund management constantly monitors business conditions, legislative enactments, labor problems, and international events and makes the appropriate revisions in the Fund's investments as the situation dictates. Funds provide the professional management and constant attention which an individual could not hope to provide for himself.[32]

More than half of the various Mutual Funds are of the type known as Diversified Common Stock Funds. These Funds invest the majority of their money in a selection of diversified common stock, with a small proportion in bonds and preferred stock for defensive purposes.

The second largest category of funds is that of Balanced Funds. Balanced funds invest in the same securities as the Diversified Funds, however, a greater proportion is in bonds and preferred stock. The effect of these two types of funds is that Common Stock Funds tend to outperform Balanced Funds in a rising market, but lose more in a falling market.

The third general category of Funds available are the Specialty Funds. They generally invest in certain industries such as oils, steel, chemicals,

[32] Goldberg, op. cit., p. 53.

autos, etc. As the industry grows, so do the Funds.[33]

Funds are established for the purpose of achieving various goals. Some Funds concentrate on growth, others on security, and still others on income. All Mutual Funds come under the Investment Company Act of 1940 which regulates the maximum percentage quantities of any one security the Fund can hold and excuses the Funds from federal corporate taxes if they distribute at least 90% of investment income to stockholders.[34]

Funds may be established as "open end" or "closed" funds. In a "closed" fund, the amount of shares is fixed and only that amount will be sold. Acquisition of shares necessitates the relinquishment by some other holder.

Most Funds are "open end". Shares will be sold indefinitely as long as people are willing to buy. The Fund will also repurchase all shares for sale by shareholders. The share value for additional shares is calculated daily, based on the market value of net assets and outstanding shares.

The administrative and management costs of operating various Funds vary with the different Funds. Some Funds are "loaded" with a percentage fee at the time of share purchase. The load fee is currently about 8% for purchase of Fund shares for amounts less than $25,000. There is no fee for the sale of shares or for purchasing additional shares with dividend payments. There are also "no load" Funds which obtain administration expenses prior to profit distribution.

With 8% of the investment money lost due to load fees of Funds, it is obvious that for any reasonably acceptable yield, they must be held for a long period of time. In general, "loaded" Funds have been outperforming "no load"

[33]Ibid., pp. 54-56.

[34]Ibid., p. 57.

Funds in growth and dividends if held for over 5 years. Two known Funds have had an average compound growth of over 19% on original investment for 6 and 10 year periods.

The Investment Decision.

Where should money be invested? How much money should be left in secure bonds? Which stock should I buy? Which Funds will grow the fastest? Many different answers are likely to be obtained for each question. The ultimate decision, of course, must be with the individual whose money is being used.

The educated and informed individual is more capable of an intelligent decision than a "random guess". An analysis of needs, goals, and monetary limitations may narrow the field of possibilities. It appears likely that an acceptable long range investment growth is obtainable with capable management from Mutual Funds. However, *if* the proper stock was purchased, the growth could be multiplied many times!

The approach to investing *least* likely to lead to effective results is to assemble a miscellaneous collection of securities without any central plan.[35] With some research and sound guide-lines, investing in common stock need not be entirely foolhardy. Nearly all Common Stocks can be classified as: (1) income stocks, (2) growth stocks, or (3) cyclical stocks.[36]

For use as an investment in an estate plan for the military officer, the desired investment purpose is "growth". Income stocks will have a greater attraction upon retirement. Cyclical stocks (volatile industries where earnings fluctuate more widely than average under varying business conditions) normally

[35] Babson & Babson, *op. cit.*, p. 132.

[36] *Ibid.*, p. 133.

require constant supervision and have little attraction for an officer's estate at early ages.

Growth stocks are those of companies in industries whose sales increase at a faster rate than the national economy as a whole, and whose earnings are more than the average of all companies. Growth stocks are most commonly found in industries where research is a major factor. New products and processes with patent protection prevent severe competition.

Certain characteristics are usually evident in companies which are subject to high growth stock potential. The most significant are:[37]

1. The company's managment should be research minded. The companies that have been making the greatest progress and those most likely to continue are in the forefront of industry.

2. The company's outlay for direct labor should be in low ratio to its total production costs. The makes it less vulnerable to the continued advance in wage rates and fringe benefits.

3. The company should have a record of consistently high profit margins. A generous margin allows management to finance growth by internal rather than external means.

The investment portion of an estate should not be considered static. As the estate plan needs continual updating, so may investment decisions based on current trends. If the wrong decision was made, being afraid to admit the error by continuing the operation will rarely rectify the problem. Small losses show much better intelligence than avoidable large ones.

[37] Babson & Babson, op. cit., pp. 145-47.

Buying and Selling Stocks and Bonds.

Where do you buy stocks, bonds, and mutual fund shares? How much does it cost in broker's fees? Can I invest small amounts? These questions deserve some discussion.

It is not necessary to have $5,000 or $10,000 to invest before going to a broker's office to engage in stock market transaction. Modern brokerage offices operate a highly mechanized and efficient organization and operationally it makes little difference whether they buy or sell ten shares or ten thousand. The broker may not break open the champagne at the sight of your smiling face at the door with a few dollars, but he will give you the courteous consideration to which any customer is entitled.[38]

Orders for shares in multiples of 100 are called "round" lots. Any order for one to 99 shares is an "odd" lot. The brokerage fees (proportionately) are less for "round" lot purchases. Additionally, the fee is on a decreasing percentage scale with the dollar size of the transaction. The brokerage fee for small purchases (less than $250) is a sizeable percentage (4-5%) due to an additional fixed amount applicable to each transaction. The fee is applicable to both purchases and sales, so frequent "trading" may well absorb any financial benefits in brokerage fees.

Most brokers are members of the New York Stock Exchange and as such have the communications and operations necessary for almost instantaneous transactions.

These firms also are in a position to carry a short term account with monthly billing and accounting for the customers. Once established as an account customer, transaction of stock trades are easily accomplished by

[38]Gellerman, op. cit., pp. 129-31.

telephone. While brokers may answer direct questions regarding stock sales and trends, and offer opinions, the ultimate responsibility for any transactions rests <u>entirely</u> with the customer.

Many Mutual Funds are also available through the regular stock brokers. Others are only available from investment firms and Fund brokers. As previously mentioned, a fee of 8% of the sum invested is charged as a broker's and administration fee for the purchase transactions. Arrangements are normally made for regular periodic investments. The regular share purchases insure that the average share cost will always be between the market high and the market low for any period of time.

Mutual Funds normally require an initial minimum investment before accepting small periodic sums for future investing. Some Funds are joined for as little as $150 plus regular investments of $25 per month or bi-monthly. Dividends can either be taken in cash or used to purchase additional shares (for which no "load" fee is charged). There is normally no fee to sell shares to the Fund.

Funds vary in their management ability, growth, goals, or income producing capabilities. The prospectus of several Funds should be studied to determine which one(s) is (are) most likely to meet the purpose for which the investment is intended.

IV. OPTIONS FOR THE ESTATE SETTLEMENT

Some plan of settlement of the estate is necessary in the event of the death of an individual. With a sizeable amount of insurance that must last several years, there is little object in receiving it in a "lump-sum" from an insurance company.

One settlement option offered by insurance companies is the "anuity settlement". A guaranteed monthly payment is available to the policy beneficiary

for life (or other specified period) based on the face value of the policy and the age of the beneficiary. At the beneficiary's option, an annuity for "ten years certain", "20 years certain", or "life" can be selected. The 10 and 20 years "certain" indicates that if the primary beneficiary were to die, the annuity payment can be received by some other designated person for the remainder of the 10 or 20 years. On the life annuity, the insurance company's obligation is completed upon the death of the primary beneficiary, even though only one payment may have been made. Mortality tables and interest rates are reflected in the establishment of annuity payments selected by a beneficiary. At the higher ages (shorter potential payment time and higher mortality rate) there is a sizeable difference in the payments received under the various annuity plans, however, for a 35 year old woman, the difference between the plans are only one or two cents per month per $1000 annuity. The "life annuity" selection results in the greatest monthly payment in all cases.

In general, an annuity from a life insurance company for people under about 50 years of age is a poor investment.[39] The company must make conservative assumptions as to rates of mortality and interest. As a result, the income available under an annuity may be no more than that available on high yield securities where the principal remains intact indefinitely.

While insurance companies can make provision for any type of settlement plan, certain conditions would make other types of activities a wiser choice. This would be particularly true if the estate consisted of several types of investment securities and the widow or family is incapable of handling the estate themselves.

[39] Joseph B. Maclean, Life Insurance (New York: McGraw-Hill Book Company, Inc., 1962), p. 55.

A Trust Company may be appointed as estate administrator. For a small fee, they will invest the estate holdings in securities that will enable the necessary and scheduled amounts to be paid to the survivors based on the desired plan provisions.[40]

Whatever the method selected for the estate settlement (if the occasion arises), the options should carefully be weighed to select the one from which maximum benefits are obtained.

V. COMPLETING THE ESTATE PLAN

Lt. Clever now has a better understanding (hopefully) of the methods available to build his estate to meet both immediate needs and long-range goals. With the backgound information and a little inexpensive "comparative shopping", he was able to select methods of meeting his immediate needs and get a start toward future goals. He has selected his plans on the criteria of Protection, Savings, and Investment. While he now realizes he should have been concerned about "estate planning" previous to now, he also realizes he can never start any sooner.

What does Lt. Clever do? He realizes several things about his present position and the family way of life. He decides that the "two month's savings" for emergencies is not a particular problem to the military officer. Medical benefits are provided. Income is regular and not subject to interruptions due to illness. Emergency leave (if necessary) can be taken care of with funds available, or his credit rating entitles him to a personal bank loan. Also, he has decided to start his estate building now with $70 per month.

[40]Goldberg, _op. cit._, p. 15.

Lt. Clever now obligates his money to:

1. A $50 Government Savings Bond (at maturity) per month. Cost $37.50 and purchased by allotment. This is considered as secure an investment as possible. Continued regular investment will provide over $4000 if needed for the educational fund in 14 years.

2. A $20,000 ordinary life policy purchased from a company of sound reputation that caters to servicemen. Because of a selected clientele and no agents, the premium is considerably less than he was able to obtain from other companies. The premium on this policy is approximately $26 per month. In 14 years it will have a "cash value" of approximately $3000 (not including probable accumulated dividends and interest). If not needed at that time, the policy provides him with potential additional "retirement income options" or "paid-up insurance" as the estate plan might dictate.

3. A $20,000 policy of group term insurance offered by a military foundation. This policy is essentially an increasing premium, constant coverage type. The premium is $6 per month until age 30, then it will go up to $7 per month. At age 35, he may need less insurance and less expensive plans are available from other companies at that age group.

Within Lt. Clever's present constraint of $70 per month he has: (1) met the <u>immediate</u> requirement of $40,000 life insurance, (2) started a secure investment program of "liquid" securities, and (3) made a provision for additional "cash" estate contingencies if they should materialize in the future.

Lt. Clever intends to commence regular Mutual Fund investments with any additional funds available for estate building <u>unless</u> circumstances dictate a need for more insurance (such as an addition to the family). He feels that with his limited knowledge of stocks and limited time, proven Funds can provide

him with the growth potential he desires with the greatest security.

He planned poorly, you say! He should have bought all "term" insurance and put the other $20 in funds! At the 19% growth rate previously cited, in just ten years, $20 per month would be worth over $6,500!

While such a plan "looks good on paper", two major fallacies are evident. The primary one is that while Mutual Funds have shown growth, there is no guarantee of anything with that type of investment.[41] At this level of estate building, the guaranteed savings, investment, and fixed premiums are more valuable than accepting any risk for potential growth.

In addition, Lt. Clever understands himself (and people in general). Like people whose savings are built with "what's left over", it is easy to "invest next month (the market doesn't look too good this month anyway) but buy the new golf clubs now". But few people would place the family's future in jeopardy by letting an insurance policy lapse for golf clubs. The recognition of "human weakness" can prevent many future hardships. The fact that the "weakness" must be "paid for" has the same justification as "costs of smoking".

Each individual must evaluate his family position, their survivor needs, the future, their goals, their personal limitations, their expenses, the economy, and the alternative methods of estate building. By proper utilization of estate planning principles at an early age, every military officer can obtain a "peace of mind" and financial security for life.

The estate plan is not static. It should be frequently reviewed (at least bi-annually) and modified as the current position dictates. The initial (or updated) methods of estate planning should then be applied.

[41] R. C. Allen, The Truth about Life Insurance (Louisville, Kentucky: Insurance Reporting Service, 1962), pp. 37-43.

CHAPTER V

SUMMARY AND CONCLUSIONS

I. SUMMARY

All military personnel on active duty have a sizeable estate as a result of military service. The estate value for the security of the family and the potential retirement estate are both governed by pay grade and length of service. Either estate provided as a service benefit would normally be inadequate by itself and additional estate building becomes the responsibility of the individual concerned.

All servicemen and their families are aware that certain monetary benefits are available to the family in case of death or retirement. Unfortunately, few have critically analyzed the potential value of these benefits compared to family needs. A "peace of mind" of both the individual and his family is available by investing the planning time and funds necessary to obtain a lifetime of financial security or family independence in case of the death of the serviceman.

While the subject of estate planning may be considered a task for professionals, by following basic principles and guide-lines, an adequate estate model can be constructed portraying both "present estate" and "estate needs". A systematic program for equating these factors must then be undertaken.

Present estate deficiencies are normally met most inexpensively by some form of insurance. "Term insurance" is the least expensive at any particular moment, but other types of insurance have attraction for meeting future foreseeable contingencies. Estate plans (and actions) which include foreseeable

problems are much more sound and inexpensive in the long run.

The criteria of protection, security, and investment are sound successive goals to seek in building an estate. The amount of an insurance premium which is invested regularly in any investment might become more valuable than insurance _if_ you die of old age. Insurance, however, offers the family protection from financial insecurity if you should die tomorrow.

Many types of insurance and investments are available on the market today. Each has its purpose and its price. Some types are more compatable with a military officer's estate plans than others. Real Estate is generally considered a good investment, but the "absentee ownership" necessitated by duty relocation precludes the maximum investment benefit to the military officer.

Each investment has a "personality" of its own. The risk, potential growth, income value, and cost of each "candidate" must be analyzed. Only then can a proper decision of selecting the investment(s) most likely to meet the estate needs be made.

Estate planning is not static. Periodically the estate plan must be reviewed and updated. Joint planning with as many members of the family participating as possible is highly recommended. A young widow can obtain maximum benefit from an estate if she has participated in the planning and understands the steps necessary to place the plan into effect.

The estate plan of each family has different problems and solutions than that of other individuals. Personal habits, living standards, goals, and ideals require that estate planning be based on personal values and deisions. It is impossible (at this time) to establish an "imperical formula" that can solve the estate planning problem for all persons.

II. CONCLUSIONS

A military officer's managerial abilities should also be utilized in a sound program of estate planning as well as the pursuit of a military career. Each officer has the moral and social obligation to provide himself and his family with a "peace of mind" from financial worry that will allow professional decisions to be based on the case elements and not influenced by "exterior pressures".

Estate planning can be challenging and exciting. The development of an estate model is easily accomplished by following certain basic principles. Building the estate is a simple matter of weighing alternatives and making a decision. Guide-lines for the correct decision enable the individual to make a decision based on his own personality and financial goals.

The material presented in this paper is sufficient for a basic understanding and accomplishment of estate planning for the average military officer. Masses of additional material is readily available and "professional" advice is "pounding on the door" daily in the form of some salesman or agent. A "fringe benefit" of this material should be a conversational understanding of the elements so as not to be "duped" by unsaid implications and promises of salesmen.

The study and trend analysis of investments can be a very interesting and rewarding hobby. By a little diligent study and the investment of no more than that required of many other hobbies, an individual could become quite wealthy.

Maclean's Life Insurance and Babson and Babson's Investing for a Successful Future are particularly well written and easily understood books recommended for additional information.

An application of a little time and money can insure a family's financial security for a lifetime!

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